McCarthy Asset Management, Inc.
Personalized Wealth Management

December 2019 Monthly Commentary/Q4 Qtr Letter

January 2, 2020

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Stock Market & Portfolio Performance

Fourth Quarter 2019: Stocks prices surged in the 4th quarter, resulting in solid returns for full year 2019. Bonds rose modestly for the quarter, posting good gains for the full year.

	4th Qtr	Year 2019	Description:
Without Dividends:			
S&P 500	8.5%	28.9%	500 Largest Public U.S. Companies
Russell 2000	9.5%	23.7%	2000 of the smallest U.S. stocks
MSCI EAFE	7.8%	18.4%	international stock index
U.S. Aggr Bond	0.2%	8.7%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	6.4%	18.8%	non-very conservative MAM portfolios
MAM Conserv	4.7%	14.6%	portfolios with 50%+ bond allocation

The returns showed above are unaudited. Past performance is not indicative of future results. Returns for McCarthy Asset Management Portfolios ("MAM Portfolios") are net of management fees and transaction costs, and reflect the reinvestment of dividends. Results represent a composite of clients using a similar investment strategy, individual results will vary.

Returns for the indices are provided solely as a general indication of current market conditions. MAM Portfolios are not invested in a style substantially similar to any index. Indices do not reflect the deduction of management fees or transaction costs or the reinvestment of dividends. Performance for the indices would be lower if these costs were reflected.

Advisor Team

McCarthy Asset Management, Inc.

Three Lagoon Drive Suite # 155
Redwood Shores, CA 94065
USA

STEVE McCARTHY
CPA, CFP®,
Owner and Principal
650 610-9540 x 303
steve@mamportfolios.com

LAUREE MURPHY, CFP®, EA
Financial Planner
Tax Specialist
650 610-9540 x 304
lauree@mamportfolios.com

ANTHONY BERTOLACCI , EA
Director of Compliance
Tax Accountant
650 610-9540 x 302
anthony@mamportfolios.com

MARILYN BLANCARTE, PACE
Executive Assistant
650 610-9540 x 305
marilyn@mamportfolios.com

2020 Economic & Stock Market Outlook

With the bull market now in its 11th year and after a very strong 2019, it is fair to ask whether this market still has room to run. While we don't have any unique insight into the short-term direction of the stock market, we feel additional moderate gains are likely. Catalysts include the U.S. economy showing steady growth, a likely increase in global growth, corporate earnings expected to resume growth in 2020, and interest rates likely to remain low after three Federal Reserve cuts in 2019. **With this backdrop, we expect the equity bull market to continue—at least for now. Furthermore, we expect stocks will outperform bonds for the year, but with gains much more muted than in 2019.** One risk for 2020 is next November's Presidential election.

The Economy

U.S. Economic Growth: The U.S. economy continued to experience moderate growth in 2019. While business capital spending has been soft due to concerns related to the U.S.-China trade dispute, consumer spending has remained solid due in part to near record low unemployment of 3.6%.

Global Economic Growth: Global growth suffered a slowdown in 2019. This slowdown is expected to reverse soon in response to easier financial conditions and an end to the trade escalation. Recently, the International Monetary Fund projected global economic growth of 3.4% in 2020, up from 3.0% for 2019.

No Recession in Sight: Despite a number of pundits predicting last year that a recession was close at hand, we continually felt that no U.S. recession was in sight. We still feel that the start of the next recession is at least a year away. Avoiding the onset of a recession bodes well for our equity outlook as, historically, the worst performance of the stock market is the four to six months leading up to the start of a recession.

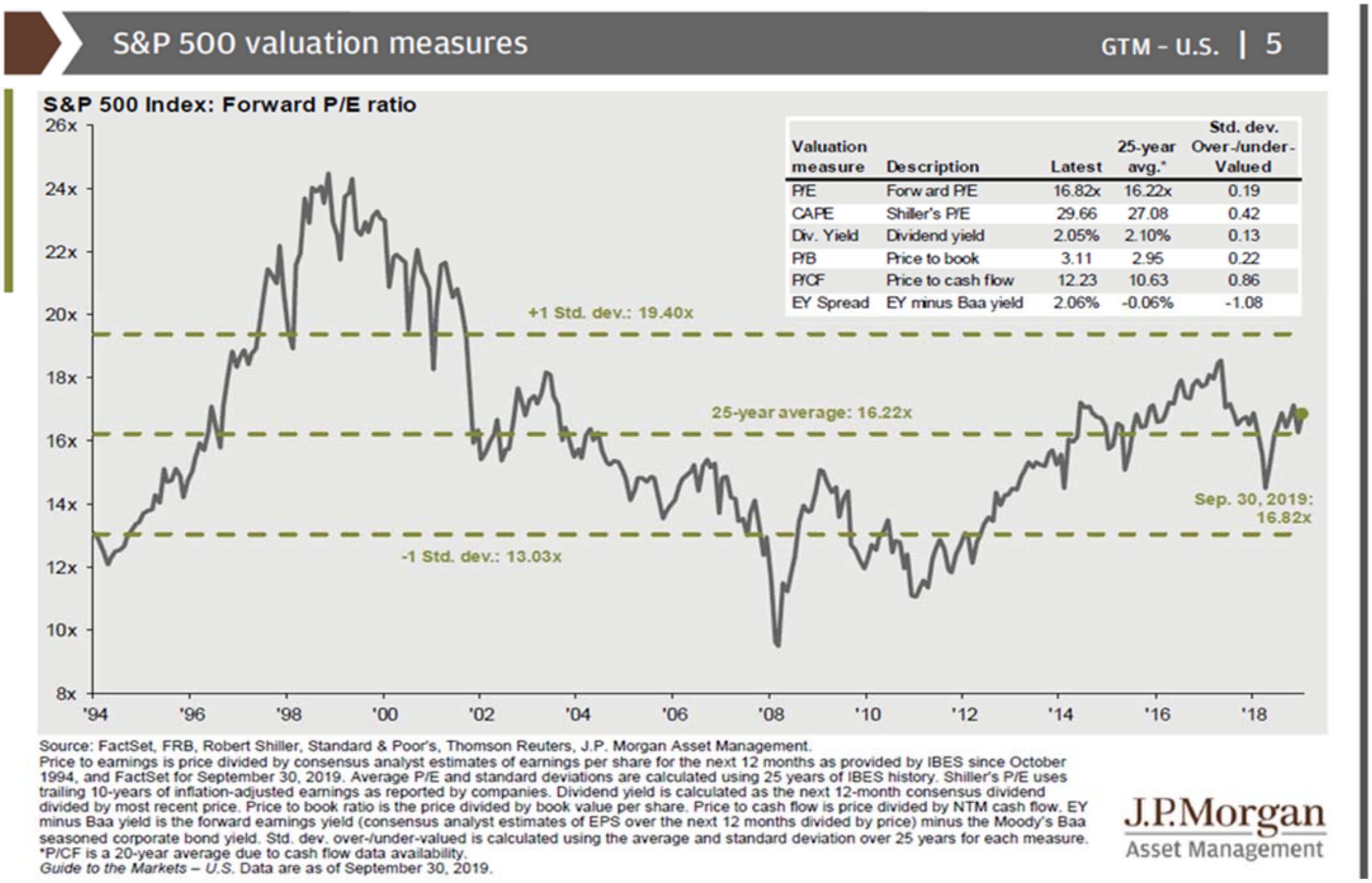
Interest Rates

The Federal Reserve: After raising the federal funds rate four times in 2017 and three times in 2018, the Fed reversed course in 2019 and lowered rates three times. Currently the federal funds rate is at a modest level of 1.50% to 1.75%. At its most recent meeting, the Fed indicated that rates are likely to remain unchanged for 2020. The 10-year Treasury rate, which is more indicative of mortgage rates, ended 2019 at 1.92%. Economists currently expect the 10-year Treasury rate to climb modestly in 2020 to a range of 2.25% to 2.50%.

Stock Price Valuation

Elevated Values: Stock market valuations are relatively high, with the forward price-earnings ratio of the S&P 500 at roughly 18, higher than its 25-year average of 16. As can be seen on the J.P. Morgan chart below, this is nowhere near the euphoric levels of the late 1990s, when P/E multiples were consistently in the 20s. (Note the chart shows a forward price-earnings ratio of 16.82, which was the ratio as of 9/30/19, prior to the stock market rally in the 4th quarter of 2019):

2020 Economic & Stock Market Outlook- Con't



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	16.82x	16.22x	0.19
CAPE	Shiller's P/E	29.66	27.08	0.42
Div. Yield	Dividend yield	2.05%	2.10%	0.13
P/B	Price to book	3.11	2.95	0.22
P/CF	Price to cash flow	12.23	10.63	0.86
EY Spread	EY minus Baa yield	2.06%	-0.06%	-1.08

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since October 1994, and FactSet for September 30, 2019. Average P/E and standard deviations are calculated using 25 years of IBES history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Price to book ratio is the price divided by book value per share. Price to cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure.
*P/CF is a 20-year average due to cash flow data availability.
Guide to the Markets – U.S. Data are as of September 30, 2019.

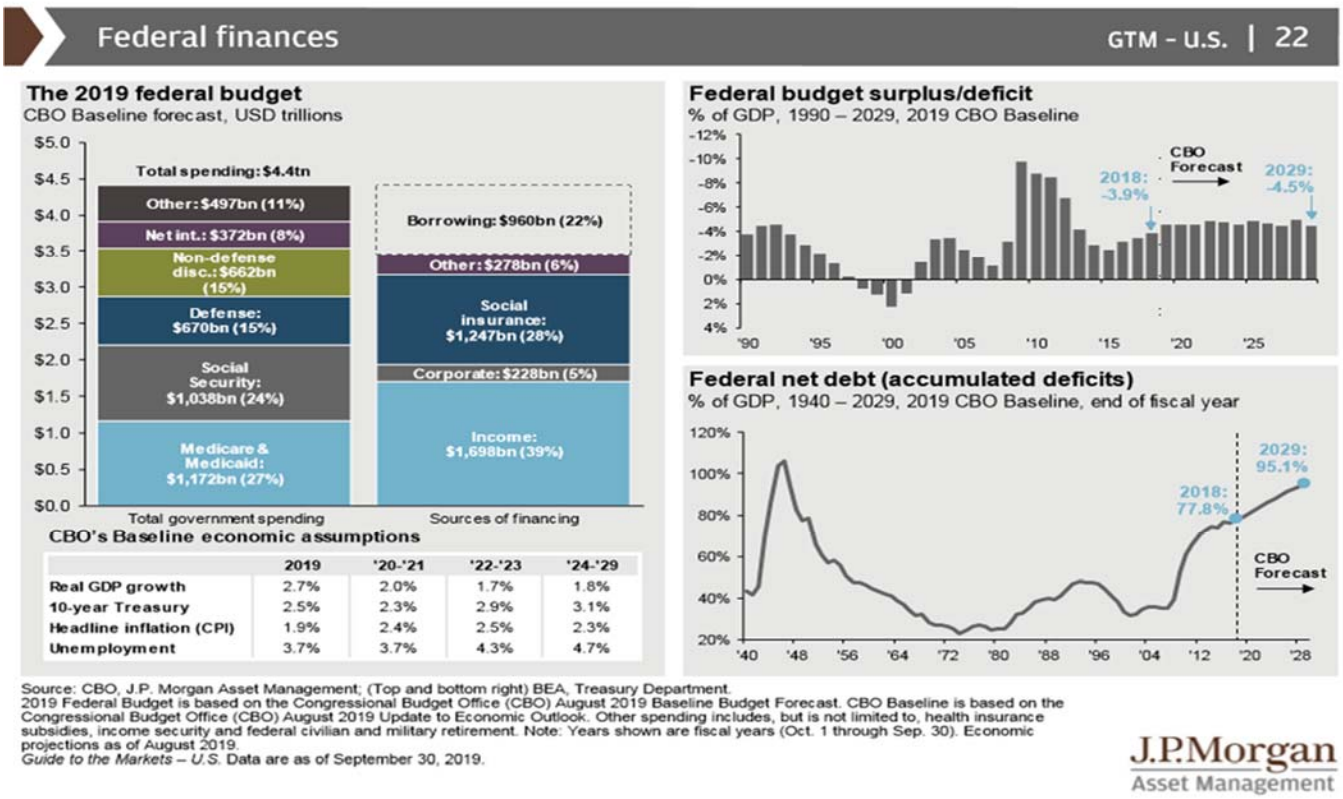
Decent Corporate Earnings Growth Expected for 2020: Earnings growth for the S&P 500 companies has been close to nil for 2019, after very strong growth in 2018 due to the Trump corporate tax cuts. Moderate earnings growth is expected to resume in 2020 with earnings currently projected to grow at a mid-single-digit rate from that of 2019.

Will the U.S. Have a Debt Crisis?

The federal deficit for the budget year ending September 30th surged 26% from 2018 to 2019, reaching $984.4 billion—its highest level in seven years. The deficit is widely expected to top $1 trillion in the 2020 budget year and likely remain there for the next decade. The year-over-year widening in the deficit reflects revenue lost from the 2017 Trump tax cut and a budget deal that added billions in spending for military and domestic programs.

The left portion of the J.P. Morgan chart on the next page displays the breakdown of the $4.4 trillion in government spending based on the budgeted amounts for 2019. With the fiscal year now over, the actual amounts for 2019 were government receipts (revenue) totaling $3.4 trillion, 3.8% higher than the previous year, while federal spending rose 8.2% to $4.4 trillion. The three biggest spending increases were recorded in the Medicare program, Defense Department and net interest on the national debt. The Medicare program saw spending rise 10% to $783 billion, the Defense Department experienced an increase of 8% to $654 billion; and net interest on the national debt rose almost 16% to $376 billion.

Will the U.S. Have a Debt Crisis?- Con't



Deficits have now increased 68% from when President Trump took office, despite his campaign pledge to eliminate the federal debt in eight years. The massive tax cuts from the 2018 Tax Act is a significant reason for the increase. Trump isn't the only one to blame. Federal spending has continued to rise significantly under Democrats and Republicans, and lawmakers have shown little appetite for reining in federal spending or raising taxes. Meanwhile, investors are unfazed by the rising government red ink.

More concerning is that these huge deficits are occurring while the economy is in a record-long economic expansion. By comparison, the last time the jobless rate was below 4%, in 2000, the U.S. ran a budget surplus of 2.3% of GDP. And in 1969, when the jobless rate last touched 3.7%, the U.S. ran a budget surplus equal to 0.3% of GDP. *If the U.S. is running trillion-dollar deficits during an economic expansion, how high will deficits go during the next recession?*

Long-Term Budget Outlook: Under current law, large budget deficits over the next 30 years are projected to drive the federal debt from 78% of Gross Domestic Product in 2019 to 144% by 2049. That projection incorporates the Congressional Budget Office's (CBO) estimates of various factors, such as productivity growth and interest rates on federal debt.

CBO projections are rarely accurate, but neither are anyone else's. In this forecast, there are no expectations of a war, a severe recession or high inflation. With the expected increase in the total Federal debt, interest payments on the national debt are projected to grow inexorably from 1.4% of GDP now, to 5.8% in 30 years. Even if the non-interest portion of the deficit as a percentage of GDP stays around 3.0%, the total annual deficit as a percentage of GDP will grow from 4.4% for 2019 to 9.0% by 2049.

Will This Become a Problem? We believe that high and growing government debt will eventually become a burden on economic growth. This is in contrast to a new school of economic theory known as the "modern monetary theory." It argues that major economies such as the United States and Japan don't have to worry about running deficits because their central banks can print as much money as they need. Fortunately, this erroneous thinking remains a distinct minority view among economists. Most still correctly believe that while the huge deficits are not an immediate threat, at some point they can become a big problem. They will crowd out borrowing by consumers and businesses, which could elevate interest rates to levels that ignite a recession.

Will the U.S. Have a Debt Crisis?- Con't

What Can be Done? Unfortunately, there are no easy answers. The policies that would be required to address the growing deficits are very difficult, if not politically impossible, at this point. Concerns about rising deficits and debt have been absent from the presidential campaign trail, in contrast to previous election cycles. Instead we hear a debate about "Medicare for All" that would likely cause the deficit to skyrocket. While we don't view the rising deficits as a short-term issue, eventually (perhaps in 10 or 20 years), it could become more of a crisis. Probably only then will politicians take action.

Implications for MAM Clients: Just to be clear, we don't see rising deficits as having a negative economic impact in the foreseeable future. Eventually, though, politicians will need to finally start addressing the issue. In so doing, it is likely that income taxes will increase and there could be entitlement reform that reduces Social Security and Medicare benefits. Also, soaring government debt could motivate the Federal Reserve to increase inflation by increasing the money supply. Any and all of these steps may negatively impact the financial security of retirees, and therefore should be factored in when estimating the long-term rate of return for portfolios and the assumed rate of future inflation for retirement spending.

A New Option for Paying for Long-Term Care
By Allen Hamm

The long-term care insurance industry has struggled for decades. Since most people aren't anxious to talk about the possibility of becoming physically or mentally dependent, the majority of Americans have avoided considering long-term care (LTC) insurance. The people most interested in obtaining insurance are the ones who have developed a health condition that precludes them from obtaining it. These facts have resulted in fewer and fewer people purchasing coverage, as well as fewer insurance companies interested in offering it.

Hybrid LTC Insurance is one type of LTC insurance that's been available for about a decade. These policies offer long-term care insurance, along with life insurance. A person buys a life insurance policy that pays a benefit to that person's beneficiary(s) upon the insured's death. However, if the insured needs long-term care before they die, they can draw from the life insurance benefit to pay for their long-term care.

When these policies first appeared, I performed a lengthy analysis of their value and concluded that, for most people considering LTC insurance, traditional LTC insurance was a better value. But in the past two years, as traditional coverage has gotten more limited and more expensive, the Hybrid policies have started offering lower premiums and improved benefits.

For example, unlike traditional LTC insurance, where premium rates for existing policyholders can increase after the coverage is issued, many Hybrid policies have a 'locked-in' premium: premiums won't increase once the coverage is issued. This offers certainty that hasn't been available with any type of LTC insurance before now.

Another benefit of the Hybrid option is unlimited coverage. This means that the benefits payable for long-term care will be paid for as long as care is needed. The unlimited benefit option hasn't been available with traditional LTC insurance since 2012. For those with sizable assets to protect, having this option could be attractive.

Of course, there are some drawbacks to Hybrid policies. The policyholder is paying for two different types of insurance (life insurance and LTC insurance) all within one policy. You may not need additional life insurance coverage. With the Hybrid option, life insurance is included, as well as a premium for life insurance.

As I've explained in my book 'How to Plan for Long-Term Care' (obtain a complimentary copy of my book from MAM), having a plan for long-term care is an integral part of having a secure financial future. That LTC Plan may or may not include LTC insurance. But for those who could benefit from transferring some of the LTC risk to an insurance company, the Hybrid LTC insurance option is now a more viable consideration than it was a few years ago.

MAM has Allen Hamm on retainer to discuss issues pertaining to long-term care. If you'd be interested in having a consultation with Allen, please let us know.

Sincerely,

Stephen P McCarthy, CPA, CFP®,

McCarthy Asset Management, Inc.

Three Lagoon Drive Suite # 155
Redwood Shores, CA 94065
USA

Phone: 650-610-9540
Fax: 610-9541
E-mail: Steve@mamportfolios.com

Our Services

McCarthy Asset Management, Inc. (MAM) is an independent, privately owned Registered Investment Advisor firm. We provide clients with the peace of mind that comes from knowing professionals are managing their financial affairs. The services we offer include:

Investment Management Services:

- **MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.**

Financial Planning Services:

- **The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.**
- **"Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.**
- **Social Security Planning is an analysis of the best strategy for when and how to start claiming Social Security benefits.**

Tax Services: Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:

- **Tax Return Preparation**
- **Income Tax Projections**
- **Tax Minimization Ideas**
- **Tax Authority Representation**

Other Services: MAM has retained outside experts, whose services are available at no cost to our clients:

- **Long Term Care Planning– Allen Hamm of Superior LTC Planning Services, Inc.**
- **Medicare Advisory Program (MAP) - Eileen Hamm**

Reminders/Updates

1) **Estimated Tax Payments**: 4th Quarter 2019 Federal & State Estimated Payments are due January 15, 2020.

2) **ADV Part II**: You were provided a copy of our ADV Part II when you became a MAM client. As a Registered Investment Advisor, we file this this document annually with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees, experience and educational back-grounds. Each year, the SEC requires us to offer clients the oppor-tunity to receive a copy of our most recent ADV Part II. Please let us know if you would like to receive a copy

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